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TO: NIOs/E, USSR & WE

ROOM NO. 7E62 | BUILDING Hqs.

REMARKS:

FYI

FROM: Harry Rowen, C/NIC

ROOM NO. | BUILDING | EXTENSION

FORM NO. 241 1 FEB 55 REPLACES FORM 36-8 WHICH MAY BE USED. (47)

H.-O. THIERBACH

6000 FRANKFURT (MAIN)
GROSSE GALLUSSTR. 10-14, TELEFON 214-3009
DEUTSCHE BANK AG

March 8th, 1982

Dear Joseph,

in case you should still like to have a look at "facts and figures" concerning

"The Yamberg-Urengoy Natural Gas Pipeline".

With my very best regards

Yours,
Hans-Otto

Mr. Joseph Kirchheimer
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INTRODUCTORY REMARKS OF

MR. H.-O. T H I E R B A C H

AT THE COLUMBIA-HARVARD CONFERENCE
ON THE TOPIC OF
"UNITED STATES-SOVIET RELATIONS - THE NEXT STAGE?"
AT ARDEN HOUSE, HARRIMAN, NEW YORK
PANEL DISCUSSION:
"THE YAMBERG-URENGOY NATURAL GAS PIPELINE"
MARCH 6TH, 1982

MR. CHAIRMAN, LADIES AND GENTLEMEN!

THE YAMBERG-URENGOI NATURAL GAS PIPELINE PROJECT MAKES ECONOMIC SENSE AND YET IT HAS SPARKED AN UNPARALLELED TRANSATLANTIC CONTROVERSY. BUT IF WE TAKE A CLOSE LOOK AT THE MANY DIFFERENCES OF OPINION SURROUNDING THIS ISSUE, WE WILL DISCOVER THAT THESE DIFFERENCES WOULD SEEM LARGELY TO HAVE RESULTED FROM AN INFORMATION GAP, ALTHOUGH IN PART ALSO FROM DIVERGENT POINTS OF DEPARTURE IN ASSESSING THE RELEVANT FACTS AND FIGURES.

MY INTRODUCTORY REMARKS ARE DESIGNED TO BRING THESE FACTS AND FIGURES INTO FOCUS. AS A BANKER, MY NATURAL IMPULSE IS TO LOOK AT THE BASIC ARITHMETIC, AND IT IS TO THIS THAT I SHALL IN GENERAL CONFINE MYSELF. THE BIG PICTURE INEVITABLY INVOLVES POLITICAL DIMENSIONS WHICH GO BEYOND THE BASIC ARITHMETIC LEVEL, BUT WHICH OF COURSE SHOULD NOT COMPLETELY BYPASS IT.

IN THE LAST FEW YEARS THE US HAS IMPORTED 20% OF ITS OVERALL ENERGY NEEDS. BY CONTRAST, THE CONTINENTAL EUROPEAN COUNTRIES (EXCLUDING THE SCANDINAVIAN COUNTRIES AND THE IBERIAN PENINSULA) HAVE BEEN DEPENDENT ON IMPORTS FOR 60% OF THEIR OVERALL ENERGY NEEDS. IT IS OF CRUCIAL SIGNIFICANCE FOR EUROPE AND CONSEQUENTLY ALSO FOR THE ECONOMY OF THE FEDERAL REPUBLIC OF GERMANY THAT OUR ENERGY POLICY BE BUILT AROUND THE PRINCIPLES OF DIVERSIFICATION AND RELIABILITY, AS WELL AS ON A BALANCED LONG-TERM VIEW OF OUR DEPENDENCE ON THE INDIVIDUAL SUPPLIER COUNTRIES.

IT WAS AGAINST THIS GENERAL BACKGROUND THAT GERMANY IN 1970, 1972 AND 1974 CONTRACTED WITH THE SOVIET UNION FOR DELIVERIES OF NATURAL GAS TOTALLING 12 BILLION CBM PER ANNUM THROUGH THE YEAR 2000. AND

THAT CORRESPONDS TO ROUGHLY 3% OF GERMANY'S OVERALL ENERGY NEEDS. IN ADDITION, WE IMPORT OIL AND TO A LESSER EXTENT COAL FROM THE SOVIET UNION AND POLAND, IMPORTS WHICH BETWEEN 1976 AND 1980 CONSTITUTED AN ANNUAL AVERAGE OF 3,7% OF GERMANY'S ENERGY CONSUMPTION. THE BASIC ARITHMETIC HERE IS THAT CURRENTLY ABOUT 6,7% OF WEST GERMANY'S ENERGY NEEDS ARE BEING MET THROUGH IMPORTS FROM THE COMECON AREA.

BUT LEST WE FORGET: IT IS NOT A GERMAN-SOVIET PROJECT WHICH HAS BROUGHT US TOGETHER HERE AT ARDEN HOUSE. THE EUROPEAN-SOVIET URENGOY-YAMAL PIPELINE, WHEN IT COMES ON STREAM IN 1985, WILL SUPPLY NATURAL GAS TO AUSTRIA, ITALY, FRANCE, FEDERAL REPUBLIC OF GERMANY, BELGIUM, THE NETHERLANDS, AND INDIRECTLY ALSO TO SWITZERLAND. BY THE END OF A PRELIMINARY PHASE OF ABOUT 3 - 5 YEARS AND AN ANNUAL PRODUCTION EXPANSION OF ABOUT 20%, WEST GERMANY IN 1990 WILL BE RECEIVING 10.5 BILLION CBM FROM A TOTAL DELIVERY OF -AS THINGS STAND TODAY - 35 BILLION CBM.

HAVING OUTLINED SOME OF THE BASIC ARITHMETIC, LET ME NOW SUMMARIZE SOME OF THE CRITICAL COMMENTS OF THE EUROPEAN-SOVIET PROJECT:

1. IT HAS BEEN SUGGESTED THAT EUROPEAN ENTHUSIASM FOR THIS PROJECT, WHOSE COST HAS BEEN VARIOUSLY ESTIMATED AT BETWEEN US$ 10 BILLION AND US$ 25 BILLION, CAN BE EXPLAINED IN TERMS OF ITS BENEFICIAL IMPACT ON WEST EUROPEAN UNEMPLOYMENT FIGURES. THE PIPELINE CONSTRUCTION, IN THIS VIEW, WOULD CREATE A LOT OF JOBS BACK HOME IN THE WEST, AND THAT, MIND YOU, WITH HARD CURRENCY CREDITS IN THE RANGE OF US$ 10 TO 15 BILLION GRANTED AT BARGAIN-BASEMENT RATES. THE PIPELINE DEAL, IN SHORT, WILL PROMPTLY SUPPLY THE SOVIETS WITH A HARD CASH WINDFALL.

2. THERE IS ALSO THE SCENARIO OF WEST GERMANY BECOMING DEPENDENT ON THE SOVIET UNION AND THUS FINDING ITSELF EXPOSED TO THE DANGER OF POLITICAL EXTORTION, SHOULD THE SOVIET UNION TURN OFF ITS PIPELINE OR SIMPLY THREATEN TO DO SO.

3. AND, FINALLY, THE HUGH AMOUNTS OF HARD CURRENCIES FLOWING INTO THE SOVIET UNION COFFERS IN THE 80S AND 90S WOULD THEN, ACCORDING TO THIS LINE OF ARGUMENTATION, PERMIT THE SOVIETS TO BUY THE SOPHISTICATED TECHNOLOGY AND OTHER GOODS THAT THEY DESPERATELY NEED BOTH TO BUTTRESS THEIR ECONOMY AND TO KEEP THEIR MILITARY MACHINE ROLLING.

THIS, IN BRIEF, ARE THE ARGUMENTS THAT HAVE BEEN LEVELLED AGAINST THE PIPELINE PROJECT, BUT WHICH, I WOULD LIKE TO SUGGEST, BYPASSES THE BASIC ARITHMETIC TO A CERTAIN EXTENT. I PROPOSE THAT WE TAKE A CLOSER LOOK AT THESE THREE AREAS OF ARGUMENTATION:

AD 1.

THE PROJECT CURRENTLY UNDER CONSTRUCTION, NAMELY THE 5.000 KM 56-INCH-PIPELINE STARTING IN URENGOY, IS WORTH ABOUT US$ 10 BILLION. OF THIS AMOUNT, ABOUT US$ 4 BILLION HAS BEEN ALLOTTED FOR EQUIPMENT SUPPLIED BY THE WEST, WHICH WILL BE FINANCED IN WHOLE OR IN PART BY THE SUPPLIERS, OR RATHER BY THEIR BANKS (AND THE COSTS OF THESE CREDITS - AS FAR AS GERMANY IS CONCERNED - WILL NOT BE SUBSIDIZED). THESE FUNDS WILL BE CREDITED DIRECTLY TO THE SUPPLIERS; AND THUS AT NO POINT WILL THE FUNDS BE AT THE DISPOSAL OF THE SOVIET UNION. THE REMAINING ROUGHLY US$ 6 BILLION REPRESENT THE LOCAL COSTS, WHICH HAS TO BE BORNE BY THE SOVIET UNION.

THE KEY HARDWARE SUPPLIED BY WEST GERMANY (SO FAR ALTOGETHER ABOUT US$ 1.2 BILLION), NAMELY THE STEEL PIPES BY MANNESMANN INCLUDING THE PRIMARY PRODUCTS AND THE COMPRESSOR STATIONS BY AEG, WILL PROVIDE JOBS FOR LESS THAN 3,000 PEOPLE OVER A THREE-YEAR PERIOD. I MIGHT ALSO MENTION, IN PASSING, THAT OVERALL GERMAN EXPORTS TO THE SOVIET UNION INVOLVE A TOTAL OF ABOUT 100,000 JOBS AGAINST A WORKFORCE OF 23 MILLION.

AD 2.

THE QUESTION OF DEPENDENCE OF THE SOVIET UNION:

THE EXTENT OF GERMANY'S DEPENDENCE ON ENERGY IMPORTS AS A PERCENTAGE OF ITS TOTAL ENERGY NEEDS (AND NOT ONLY OF ITS ENERGY IMPORTS) CAN BE SEEN IN THE FOLLOWING EXAMPLES:

IN 1980 45% OF WEST GERMANY TOTAL ENERGY NEEDS WAS SATISFIED FROM ITS OWN PRODUCTION, 55% FROM FOREIGN COUNTRIES. THERE WERE MAINLY 20% SUPPLIED FROM THE GULF REGION, ANOTHER 6% FROM LIBYA, 5% FROM NIGERIA, ANOTHER 4% FROM NORWAY, 7% FROM GREAT BRITAIN AND 7% FROM THE NETHERLANDS.*)

WHEN THE FLOW OF SOVIET GAS TO THE FEDERAL REPUBLIC OF GERMANY LEVELS OFF IN 1990, SOVIET GAS DELIVERIES WILL CONSTITUTE 5.6% OF PROJECTED OVERALL ENERGY NEEDS.

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*) - AND BY WAY OF PROVIDING ANOTHER EUROPEAN EXAMPLE: BEFORE THE OUTBREAK OF HOSTILITIES BETWEEN IRAN AND IRAK, IRAK SUPPLIED FRANCE WITH 12% OF ITS NEEDS; TODAY IT SUPPLIES SLIGHTLY ABOVE 1%.

ONE MUST OF COURSE CONCEDE THAT A DEPENDENCE ON NATURAL GAS IMPORTS IS DIFFERENT FROM A DEPENDENCE ON OIL OR COAL IMPORTS, OIL AND COAL BEING MORE EASILY SUBSTITUTED.

BUT WHAT WOULD HAPPEN IF THE SOVIET UNION WERE TO CUT OFF ITS GAS SUPPLIES TO WESTERN EUROPE IN, FOR EXAMPLE, 1990, AND AS A RESULT GERMANY HAD TO COPE WITH 22,5 BILLION CBM LESS THAN PLANNED? THIS WOULD CORRESPOND TO ABOUT 30% OF TOTAL WEST GERMANY'S GAS SUPPLY CONTRACTS IT HAS AT ITS DISPOSAL, WITH THE REMAINING REST OF 70% BEING PARTLY FROM DOMESTIC PRODUCTION AND MAINLY FROM HOLLAND AND NORWAY.

A) THERE CAN BE NO QUESTION OF A SPECIFICALLY REGIONAL DEPENDENCE, FOR THE FEDERAL REPUBLIC OF GERMANY IS INTERCROSSED WITH AN INTEGRATED GAS PIPELINE SYSTEM, SO THAT A REGIONAL SHORTFALL CAN BE OFFSET AT SHORT NOTICE. THIS SYSTEM HAS A CAPACITY WHICH ALLOWS FOR A MAJOR CONSUMER IN, SAY, MUNICH TO BE SUPPLIED AT ANY TIME WITH NATURAL GAS FROM HAMBURG, OR VIA THE EUROPEAN NETWORK FROM HOLLAND OR NORWAY.

B) THE AGREEMENTS WITH THE SUPPLIER COUNTRIES PROVIDE FOR HIGHER DELIVERY VOLUMES THAN WE SHALL NEED - UNDER NORMAL CIRCUMSTANCES. GIVEN THE MAXIMUM OFF-TAKE-VOLUMES AGREED IN THE SUPPLY CONTRACTS WITH HOLLAND AND NORWAY, THIS WOULD ALLOW US TO COMPENSATE FOR A SOLID THIRD OF SOVIET DELIVERIES, SHOULD THEY COMPLETELY BE CUT OFF. IN ADDITION, WE ARE ALSO IN A POSITION TO TEMPORARILY BOOST DOMESTIC PRODUCTION.

C) SHOULD SUPPLIES IN THE GAS PIPELINE BE INTERRUPTED FOR ANY REASON, AGREEMENTS WITH THE MAJOR GAS CONSUMERS PROVIDE FOR THEIR SWITCHING AT SHORT NOTICE TO OTHER, READILY AVAILABLE SOURCES OF ENERGY. IF THE PRODUCERS OF ELECTRICITY ARE AFFECTED, THEY HAVE THE ADDITIONAL POSSIBILITY OF PLUGGING INTO WEST GERMAN OR EUROPEAN SUPPLY SYSTEMS. BIG INDUSTRY AND THE ELECTRICITY PRODUCERS, WHOSE SHARE IN THE TOTAL NATURAL GAS CONSUMPTION RUNS AT ROUGHLY 40% AND 35% RESPECTIVELY, MAINTAIN ALTERNATIVE BACK-UP SYSTEMS, WHICH CAN BE MADE OPERATIONAL AT SHORT NOTICE. THE TOTAL CAPACITY OF THESE BACK-UP SYSTEMS WOULD COMPENSATE EASILY FOR ANOTHER THIRD OF THE SOVIET DELIVERIES. THE THEN REMAINING SHORTFALL OF ROUGHLY 25% WOULD BE EQUAL TO LESS THAN 1.5% OF THE TOTAL ENERGY NEEDS OF WEST GERMANY, AND CONSEQUENTLY OF A MAGNITUDE WHICH CAN NOT SUSTAIN THE THEORY OF SOME SORT OF CRITICAL DEPENDENCE ON THE SOVIET UNION.

WE ALSO HAVE A GAS STORAGE CAPACITY OF CURRENTLY 2.3 BILLION CBM, WHICH PROVIDES US WITH A FALLBACK POSITION AND A BUFFER, DESIGNED TO OFFSET SEASONAL FLUCTUATIONS BUT WHICH CAN ALSO BE USED AGAINST TEMPORARY INTERRUPTIONS IN DELIVERIES. A TRIPLING OF THIS STORAGE CAPACITY BY 1990 TO ROUGHLY 7 BILLION CBM IS ALREADY BEYOND THE DRAWING-BOARD STAGE.

THE CONSUMER CATEGORIES WHICH I HAVE NOT YET MENTIONED, I.E. SMALL BUSINESS AND PRIVATE HOUSEHOLDS, WITH A JOINT SHARE OF 25% OF THE NATURAL GAS CONSUMPTION, WOULD NOT BE AFFECTED BY AN INTERRUPTION IN RUSSIAN DELIVERIES. AVAILABLE FIGURES MAKE CLEAR THAT BOTH COULD BE SUPPLIED FROM DOMESTIC SOURCES.

WE HAVE OF COURSE LOOKED INTO POSSIBLE ALTERNATIVE SOURCES. THE DUTCH AS WELL AS THE NORWEGIANS DO NOT SEEM TO BE PREPARED TO INCREASE THEIR PRODUCTION AND THEREBY THEIR DELIVERIES TO THE FEDERAL REPUBLIC. ALGERIA HAD APPARENTLY BEEN A RATHER COMPLICATED PARTNER NEGOTIATING WITHOUT SUCCESS OVER A PERIOD OF 10 YEARS WITH EL PASO, NOT TO SPEAK OF THE WELL KNOWN PRESENT DIFFICULTIES WITH ENI. NIGERIA, WHICH TO DATE LACKS ANY OF THE NECESSARY INFRASTRUCTURE AND THEREFORE CAN NOT BE EXPECTED TO MARKET LIQUID GAS SUPPLIES BEFORE THE 90S, AT THE EARLIEST.

THE IDEA OF TRANSPORTING ALASKAN GAS IN SUBMARINE MEGA-TANKERS TRAVELLING TO EUROPE UNDER THE ARCTIC PRESUMABLY RANKS IN MARCH 1982 AS A FUTURISTIC VISION. THIS PROJECT, WHICH WAS THE BRAINCHILD OF GENERAL DYNAMICS, HAS BEEN CAREFULLY STUDIED BY A TEAM OF GERMAN SHIPBUILDING EXPERTS, WHO COME TO THE CONCLUSION THAT IT WOULD NOT BE VIABLE BEFORE THE END OF THE CENTURY.

BY WAY OF CONTRAST, I MIGHT MENTION A TOPICAL EXAMPLE OF DIVERSIFICATION AT THE SUPPLY LEVEL, NAMELY THE PROJECTED IMPORT OF LNG FROM QATAR, WHICH WILL COME ON STREAM IN 1987/88 WITH DELIVERIES IN A MAGNITUDE CORRESPONDING TO 10 BILLION CBM OF NATURAL GAS.

AD 3.

THE ARGUMENT, WHICH I WOULD LIKE TO REPEAT VERBALY HERE ONCE AGAIN: "THE HUGH AMOUNTS OF HARD CURRENCIES FLOWING INTO THE SOVIET COFFERS IN THE 80S AND 90S WOULD THEN, ACCORDING TO THIS LINE OF ARGUMENTATION, PERMIT THE SOVIETS TO BUY THE SOPHISTICATED TECHNOLOGY AND OTHER GOODS THAT THEY DESPERATELY NEED BOTH TO BUTTRESS THEIR ECONOMY AND TO KEEP THEIR MILITARY MACHINE ROLLING.

ACCORDING TO OECD, CIA AND PRACTICALLY ALL OTHER ESTIMATES I KNOW, BY 1990 THE SOVIET UNION WILL ONLY BE ABLE TO EXPORT AT BEST GREATLY REDUCED QUANTITIES OF OIL AND OIL DERIVATES TO THE WEST. THE OECD ESTIMATES SEE THE COMECON COUNTRIES, WITH (RUSSIAN) OIL EXPORTS OF 15 MILLION TONS TO THE WEST, THEMSELVES (THE COMECON) RUNNING AN OIL DEFICIT IN THAT YEAR, 1990 OF 88 MILLION TONS. THE CIA SEES ZERO EXPORTS OF OIL TO THE WEST AS OF 1990, AND AT THE SAME TIME A TOTAL COMECON SHORTFALL OF 100 MILLION TONS. THESE DEVELOPMENTS POINT TO AN UNAVOIDABLE DEPENDENCE ON IMPORTS, WHICH IN TURN WILL PUT CONSIDERABLE STRAINS ON THE COMECON ECONOMIES.

THE ADDITIONAL ENVISAGED RUSSIAN GAS EXPORTS TO THE WEST THROUGH THE URENGOY PIPELINE CAN NOT OFFSET THE DECLINING OIL EXPORT REVENUES. ON THE CONTRARY: IN 1980 THE SOVIET UNION HAD REVENUES OF US$ 25 BILLION IN CONVERTIBLE CURRENCIES. IN 1990 - ON THE BASIS OF 1980 PRICES - THEY WILL ONLY HAVE REVENUES OF US$ 15.5 TO 19.5 BILLION ALTOGETHER COMPARED WITH, I REITERATE, US$ 25 BILLION IN 1980. AND THIS CAN BE WORKED OUT FROM THE ABOVE-MENTIONED FORECASTS BY THE CIA AND OECD.

IF, AFTER STOPPING THEIR OIL DELIVERIES, THE RUSSIANS WERE ALSO TO SUSPEND FOR WHATEVER REASONS THEIR GAS DELIVERIES TO THE WEST, THEY WOULD THEN HAVE NO MORE REVENUES IN CONVERTIBLE CURRENCIES THAN US$ 6 TO 10 BILLION IN TERMS OF 1980 PURCHASING POWER.

HERE, TOO, A LOOK AT THE BASIC ARITHMETIC REVEALS TO US THAT EUROPE IS NOT ABOUT TO PLUNGE INTO A ONE-SIDED DEPENDENCE ON RUSSIA BY INCREASING ITS GAS-IMPORT FROM THE SOVIET UNION. RATHER, IT IS RUSSIA WHICH IS MORE LIKELY TO BECOME DEPENDENT WHEN THEIR OIL EXPORTS TO THE WEST COME TO A HALT. INTERDEPENDENCE IS PERHAPS THE RIGHT WORD, BUT, NO MATTER HOW YOU LOOK AT IT, A RELATIONSHIP WITH THE SOVIET UNION IN THE WEAKER POSITION IS MORE READILY BORNE OUT BY THE BASIC ARITHMETIC THAN IS IN THIS CONTEXT A EUROPEAN DEPENDENCE ON RUSSIA.

AS A BANKER, YOU ARE ALWAYS ACCUSTOMED TO HAVING LIMITS: MONEY MARKET LINE LIMITS, CREDIT LIMITS, AND FOR A COUPLE OF YEARS NOW COUNTRY LIMITS AS WELL. IN THIS RESPECT I THINK THAT ROUND ABOUT 30% OF THE TOTAL GAS CONSUMPTION OF WESTERN EUROPEAN COUNTRIES LIKE FRANCE, ITALY AS WELL AS THE FEDERAL REPUBLIC OF GERMANY BEING SUPPLIED BY ONE COUNTRY WHICH IS NOT A MEMBER OF THE WESTERN ALLIANCE MIGHT ALSO - UNDER PRESENT CIRCUMSTANCES - BE A LIMIT. AS I HAVE TRIED TO EXPLAIN, A MANAGEABLE AND THEREFORE ACCEPTABLE LIMIT AND ALTOGETHER FOR THE RECIPIENT COUNTRIES A SUFFICIENT LIMIT. - THOUGH IT MIGHT NOT BE A SUFFICIENT LIMIT FOR THE SOVIET UNION.

THANK YOU.

Soviet Union - development of exports to the West up to 1990

Based on forecasts of CIA and OECD

A. Variable model assumptions (2 scenarios)

	1980	1990 I	1990 II
Oil exports in millions of tones (hard currency area)	ca. 60	15 (OECD)	0 (CIA)
Gas exports in billion of cubic metres (hard currency area)	ca. 23	60	
Export prices	rising to the same extent compared with 1980 as prices for Russian imports from the West		

B. Model calculation

	1980	1990 at current prices I	1990 at current prices II	1990 at 1980 prices I	1990 at 1980 prices II
Export to West (US$ bn.)	24.5	39	31	19.5	15.5
thereof: oil	15	8	0	4	0
gas	3.5	19	19	9.5	9.5
other exports	6	12	12	6	6

C. Results

On the basis of the model assumptions, Soviet exports in 1990 to the West at 1980 prices will only amount to 80% (Scenario I) or 63% (Scenario II) of their 1980 level. Excluding natural gas exports, the corresponding figures are only 41% and 24% respectively.

March, 1982